Benchmark Paper

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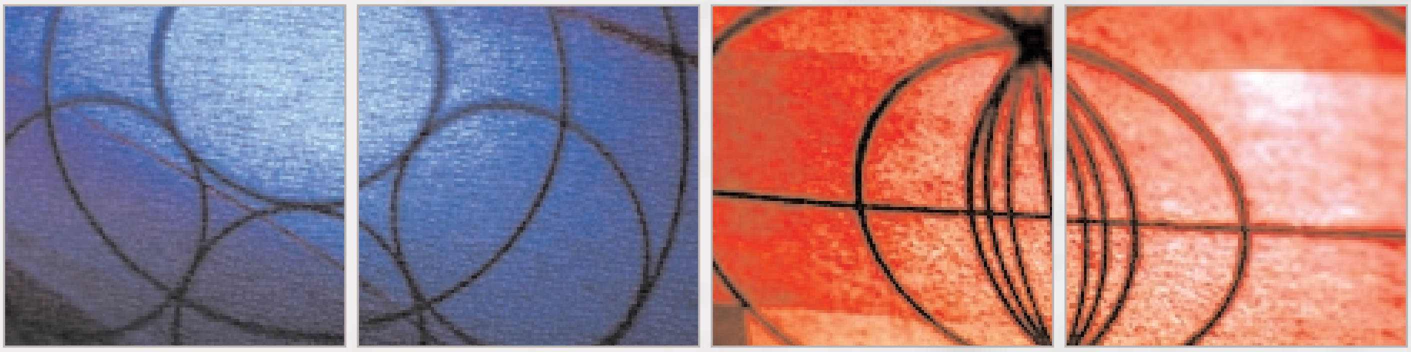

Benchmarking European Tax & Legal Environments

Indicators of Tax & Legal Environments Favouring the Development of Private Equity and Venture Capital in European Union Member States

20 years
1983 - 2003
PROMOTING EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL

evca

European Private Equity & Venture Capital Association

About EVCA…

The European Private Equity and Venture Capital Association (EVCA) exists to represent the European private equity sector. With over 950 members throughout Europe, EVCA's many roles include providing information services for members, creating networking opportunities, acting as a lobbying and campaigning organisation and working to promote the asset class both within Europe and throughout the world. EVCA's activities cover the whole range of private equity; venture capital, from seed and start-up to development capital; buyouts and buyins, and the flotation of private equity-backed companies.

Further information can be obtained by visiting **www.evca.com** or by contacting the EVCA Secretariat on Tel: +32 2/715 00 20, Fax: +32 2/725 07 04, e-mail: evca@evca.com

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Foreword

The European private equity and venture capital[1] industry - the ‘business of building businesses’ - can take pride in the strength it has displayed through what have undeniably been difficult times. Fundamentals remain strong, funds are still attracting contributions and exciting deals are still getting done. Since 1990 over €187 billion has been raised for private equity and venture capital investment in Europe's growth companies and looking ahead, there is no lack of opportunity, with a rich culture of emerging - and converging technologies creating some extremely interesting medium- and longer-term investment prospects.

Although it can trace its roots back 50 years, the European private equity and venture capital industry began to grow in earnest in the 1980s. Since then it has developed consistently, reflecting the increasing opportunities for investment arising from structural shifts in corporations and cultural shifts in research and development. At its heart it has always been a long-term business and the dramatic market corrections of recent years should be viewed in context - in cyclical terms, the industry continues to develop in line with expectations.

And, whatever the short-term consequences of the current market slowdown, entrepreneurial business will remain a key engine for European economic growth - fuelled, to a very significant degree, by the private equity and venture capital industry (whether investing in early-stage companies or financing buyouts).

EVCA’s 2002 *Survey of the Economic and Social Impact of Venture Capital in Europe* highlights the symbiosis that exists between private equity/venture capital and European entrepreneurship - 94.5% of the growth businesses surveyed said that venture capital investment had been an essential ingredient in their creation, survival or growth. 72% said that, without venture capital, they would never have come into existence. In another EVCA survey[2] (canvassing 300 European companies undertaking buyouts between 1992 and 1997), 84 per cent of respondents said that they would no longer exist, or would have developed more slowly, without the private equity-backed buyout.

Regulation and bureaucracy, on a national and a pan-European level, will have a profound influence on the onward development of a truly entrepreneurial culture in Europe. By simplifying the requirements for company formation and lightening the burden of regulatory and compliance costs, European governments can eliminate many of the potential obstacles to enterprise. To this end, EVCA continues to work closely with the European Union (EU), both through the Commission’s Risk Capital Action Plan (RCAP) and its Financial Services Action Plan (FSAP), as well as through the activities of the various directorate generals.

In particular, in its White Paper, EVCA has drawn up a checklist for fostering long-term investment in Europe’s growth companies, based on the following policy priorities:

- The promotion of stock option schemes to attract skilled personnel to young emerging companies. Favourable tax regimes for stock options should be a part of this process.
- A European-wide harmonisation in the legal structure of private equity funds to encourage cross-border investment activity and to avoid double taxation issues.
- Regulations on pension funds need to be reviewed to liberate long-term capital sources to invest in private equity or venture capital funds.
- High taxation of capital gains in some Member States hampers entrepreneurial investment, especially in high-risk early-stage companies. Unfavourable tax regimes should be reviewed with this in mind.

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[1] Venture capital is, strictly speaking, a subset of private equity and refers to equity investments made for the seed, start-up or expansion of a business. Private equity therefore consists of venture capital and buyout investments.

[2] EVCA Survey of the Economic and Social Impact of Buyouts and Buyins in Europe, Jan 2001

Although the EU institutions remain positive to EVCA's policy priorities, a lot of work is needed at the national level to motivate governments to modify their tax and legal environments in pursuit of a truly pan-European private equity and venture capital industry.

The existing fragmentation of tax and legal environments requires urgent attention. To this end, the EVCA has produced the benchmark paper '**Benchmarking European Tax and Legal Environments, Indicators of Tax & Legal environments favouring the development of private equity and venture capital in European Union member states**', a tool that enables comparison between EU member states on core issues relevant to the development of private equity and venture capital.

This pioneering initiative, which will be regularly updated, aims to explain the optimum tax and legal environments in which entrepreneurship can flourish, as well as illustrating the substantial divergence between existing EU member state tax and legal environments at a specific period in time. It does not, however, measure the entrepreneurial culture, aim to influence private equity and venture capital investment decisions, nor does it provide an indication of competitive private equity and venture capital performance in different member states - its purpose is to promote convergence, not disparity.

This paper will enable EU institutions, member state governments, stakeholders and other interested parties to look at best practices currently in place and initiate their own actions where necessary. To allow for comparisons between different national environments, information has been collected for each member state on core issues influencing entrepreneurship (fund structures, merger regulation, pension funds, company tax rates, company tax rates for SMEs, capital gains tax for individuals, tax incentives for individuals investing in private equity, taxation of stock options, entrepreneurial environment and fiscal incentives for R&D). Each issue has then been scored on a country-by-country basis (from one, for favourable environments, through to three for less favourable environments). A composite score has then been calculated for each country. Information presented refers to the information collected between February and November 2002.

EVCA would like to thank everyone who has been engaged in the undertaking of this ground-breaking initiative, the contributors who have supported the secretariat in the data collection process and, in particular, the members of the EVCA Tax and Legal committee.

There is, of course, still a long way to go before Europe's growth businesses will benefit from a truly pan-European private equity and venture capital industry. However, by highlighting the obstacles that currently stand in the way of that goal, as well as promoting existing best practice, this latest initiative should provide an important stimulus for change. Trade associations and industry will, it is hoped, use this document as a platform for discussion with policy makers in pursuit of private equity-friendly policy making throughout Europe.

Max Burger-Calderon
EVCA Chairman

2 Introduction

Introduction

Like any other industry, private equity[3] and venture capital is subject to the prevailing macro- and micro-economic environment. Depending on the entrepreneurial culture of a particular country; the availability of long-term sources of finance; the quality of the local educational system; the macro-economic policies adopted (including the stock markets' role in financing the economy) and the local tax and legal environment, private equity and venture capital will find a location either more or less favourable to its development.

This paper, produced by the European Private Equity and Venture Capital Association (EVCA), sets out a selection of important factors impacting the private equity and venture capital industry in Europe, but does not attempt to cover all of the areas mentioned above. It focuses solely on the tax and legal issues relating to the supply-side (i.e. private equity and venture capital houses and investors in the fund) and the demand-side (i.e. entrepreneurs) of the industry.

The tax and legal issues covered are as follows:

1. Fund structures
2. Merger regulation and its impact on private equity and venture capital
3. Pension funds as potential investors in private equity and venture capital
4. Company tax rates
5. Company tax rates for small and medium-sized companies (SMEs)
6. Capital gains tax rates for individuals
7. Tax incentives for individual investors investing in private equity
8. Taxation of stock options
9. Entrepreneurial environment
10. Fiscal incentives to enhance research and development (R&D)

The objective has been to produce a benchmarking tool, enabling comparisons to be drawn between European Union (EU) member states' legal and tax frameworks, insofar as they affect the development of private equity and venture capital. In this sense, the aim here is to allow EU institutions, member state governments, stakeholders and other interested parties to assess the best practices currently in place and initiate actions where needed. This document does not attempt to look at detailed specific situations per country and is in no way designed to influence private equity or venture capital fund-raising or investment decision-making.

To allow for comparisons to be made between different national environments, information on each of the 10 issues listed above was collected for each member state between February and November 2002. Each issue was then scored, country-by-country – '1' being the best score, designating a favourable condition, with '2' and '3' indicating less favourable conditions with room for improvement. Finally, a composite score was arrived at for each country by calculating the average score across all 10 issues. These composite scores allowed current conditions in all member states to be scrutinised. The methodology chapter at the end of this paper explains in detail how the different scores have been calculated. In addition, a table with the scores for each individual variable is included in the Appendices.

[3] EVCA generally refers to 'private equity' rather than venture capital with respect to the full industry. The term private equity encompasses financial investment in growth companies at all stages of their development. This includes both investment in new or expanding companies (venture capital), and investment in later stage companies (buyouts). For further industry definitions/terminology, please refer to the Glossary at EVCA's website (www.evca.com).

3 Defining

Defining a favourable tax and legal environment for the private equity and venture capital industry

The following paragraphs outline a tax and legal environment, favourable to both the supply-side of private equity (i.e. the private equity practitioners and investors in the fund) and the demand-side (i.e. the entrepreneurs). These conditions are referred to as reference guides in the evaluation per variable, per country in chapter 4.

3.1 Fund structures should satisfy the needs of domestic and international investors

The absence of an efficient domestic fund structure can result in a need to use foreign structures, thereby incurring significant transaction costs. This clearly results in a sub-optimal solution. The following concerns should be addressed for optimal fund structure conditions:

i) Tax transparency for domestic investors.
An investment through a fund should, for tax purposes, be treated as if it was a direct investment in the underlying companies. Tax transparency for the fund would avoid this potential double taxation for domestic investors.

ii) Ability of international investors to avoid a permanent establishment.
The investment of an international investor in a foreign country should not create a permanent establishment. A permanent establishment makes the international investor liable to national taxes and could potentially lead to double taxation.

iii) Ability to incorporate a tax-efficient/performance-related incentive or investment in the form of capital for fund managers of private equity and venture capital funds.

Carried interest schemes can provide private equity and venture capital funds with valuable incentives with which to attract highly-qualified fund managers. As such, they should be feasible and subject to a favourable tax regime. Moreover, they are an important mechanism for aligning the interests of investors and venture capitalists in a relationship that will last, on average, for 10 years.

iv) Ability to avoid paying Value Added Tax (VAT) on management charges and carried interest
The payment of VAT can become an irrevocable cost for the fund when VAT cannot be recovered.

v) Ability to avoid undue restrictions on the type of investments carried out by the fund.

3.2 Because their long-term perspective is in line with the best interests of the private equity and venture capital industry, pension funds should be free to invest in the asset class. The prudent man rule allows pension funds to include private equity and venture capital funds in their asset allocation according to their own needs, while respecting the risk profile of their clients.

3. Defining

Defining a favourable tax and legal environment for the private equity and venture capital industry

3.3 **Merger regulation should not burden private equity and venture capital-backed deals (which do not raise competition concerns), nor should it result in high transaction costs or create unfair competitive advantage in favour of industrial buyers.**

3.4 **Stock options should not be taxed at the date of granting, vesting or exercising, because, at that point, the profit remains unrealised. Because only realised profits should be taxable, stock options should be taxed upon sale of the underlying securities.**

3.5 **Entrepreneurship should be encouraged with simple regulatory requirements for company formation and reasonable compliance costs.**

3.6 **Capital gains tax rates for individuals should be favourable. A favourable tax treatment of capital gains on unquoted investments in growth companies is an appropriate incentive to entrepreneurial investment. Favourable tax treatment directly recognises both the risk inherent in launching, joining or backing new growth businesses, and the active and non-monetary contributions of private equity fund managers to developing growth companies.**

3.7 **Company tax rates, especially for Small and Medium Sized Enterprises (SMEs), should help to support entrepreneurship.**

3.8 **Tax incentives should be adopted for individual investors investing in private equity funds. Indeed, some countries already provide special tax advantages, such as tax deduction for possible loss or basic tax relief, as ways of rewarding individual investors for the significant personal risk they take when investing in the asset class.**

3.9 **Fiscal R&D incentives should be adopted. Several countries already implement fiscal incentives in this area in order to promote widespread innovative activity.**

4. Comparison

Results of the comparison undertaken

A - Composite score

As outlined in the introduction, an average of scores accorded per issue, per country was made in order to produce a composite score for each member state. The composite scores allow for a global comparison between member states. For the period February-November 2002, the composite score is shown in the table below and provides the following assessment:

- The UK and Ireland are the countries with the most favourable regulatory environment for the development of the private equity and venture capital industry with a composite score of 1.20 and 1.58 respectively.
- Luxembourg (1.67), the Netherlands (1.79), Italy (1.96) and Greece (1.96) are in the second group of countries, which includes those with a better than average score (<2.04).
- The third group comprises countries with composite conditions being slightly worse than average (>2.04) and including France (2.09), Sweden (2.09) and Belgium (2.14).
- Spain, Finland, Portugal and Germany follow, with scores between 2.17 and 2.41 in the lower section of the table.
- Denmark and Austria score lowest and provide the least favourable tax and legal environment for private equity and venture capital with scores of 2.48 and 2.53 respectively.

Indication of a tax and legal environment favourable to the development of private equity and venture capital. (1= more favourable / 3= less favourable)

European Union Member States

Country	Total Score
UK	1.20
Ireland	1.58
Luxembourg	1.67
Netherlands	1.79
Italy	1.96
Greece	1.96
Total Average	**2.04**
France	2.09
Sweden	2.09
Belgium	2.14
Spain	2.17
Finland	2.25
Portugal	2.32
Germany	2.41
Denmark*	2.48
Austria	2.53

Source: EVCA

This table does not measure the entrepreneurial culture, does not aim to influence private equity and venture capital investment decisions, nor does it provide an indication of competitive private equity and venture capital performance per country.

* Denmark was evaluated on only nine of the 10 variables, due to the lack of a conventional private equity structure in this country.

Results of the comparison undertaken

B - Explanation of the current environment country-by-country:

The following section provides some background to the individual countries' composite scores and identifies possible areas for action. The countries are listed in alphabetical order and the information provided is divided into favourable and unfavourable conditions.

- Austria
- Belgium
- Denmark
- Finland
- France
- Germany
- Greece
- Ireland
- Italy
- Portugal
- Luxembourg
- The Netherlands
- Spain
- Sweden
- UK

For a more detailed explanation of the individual variables used, please see the Methodology chapter, which follows.

Austria (2.53):

Austria is characterised by a *favourable* environment in terms of:

1. **Fund structures (Mittelstandsfinanzierungsgesellschaften - MFAGs):**
   - A permanent establishment for international investors can be avoided.
   - They can incorporate a tax efficient capital investment/incentive for fund managers.
2. **Tax incentives for private individuals:** Distributions from MFAGs are, up to a certain amount (€14.600) tax-free.

Austria has an *unfavourable* environment in terms of:

1. **Fund structures:**
   - MFAGs are not tax transparent for domestic investors' income tax purposes, even though some tax exemptions apply under certain conditions.
   - Management charges and carried interest are subject to VAT.
   - There are undue restrictions on the type of investments undertaken.
2. **Merger Regulation:** The notification of a merger is mandatory and there is an obligation to suspend a deal until the responsible authority (ies) takes a decision.
3. **Pension funds:** Pension funds (Pensionskassen) can invest in private equity but only up to 5% of their total fund assets (quantitative restriction).
4. **Company tax rate:** Austria has a company tax rate of 34%, which is above the EU average (32.6 %).
5. **Company tax rate for SMEs:** There is no specific company tax rate applicable to SMEs.
6. **Capital gains tax rate for individuals:** The Austrian capital gains tax rate of 25% is above the EU average (18.6%).
7. **Stock options taxation:** Stock options in Austria are taxed on exercise.
8. **Entrepreneurial environment:** The entrepreneurial environment in Austria is less favourable as it requires larger amounts of capital to set up a business and the administration costs involved are also higher, compared to other EU countries. This evaluation is based on a study undertaken by the European Commission on the administration of business start-ups 'Benchmarking the Administration of Business Start-Ups', European Commission, 2002, which is outlined in more detail in the methodology.
9. **Fiscal R&D incentives:** From the six possible fiscal R&D incentives included in the evaluation, namely tax incentives for business R&D expenditure, for R&D capital expenditure, technology transfer, the contracting of researchers, the cooperation between firms and research institutes/universities and the creation of innovative firms, Austria provides a tax incentive only for R&D capital expenditure. This information is based on the publication 'Corporation Tax and Innovation', European Commission, 2002.

Belgium

Belgium (2.14):

Belgium is characterised by a *favourable* environment in terms of:

1. **Fund structures (Limited Company or PRIVAK):**
   - A permanent establishment for international investors can be avoided.
   - A tax efficient capital investment/incentive for fund managers can be incorporated.
   - Carried interest is not liable to VAT.
   - There are no restrictions on the type of investments undertaken (PRIVAK is subject to restrictions).
2. **Company tax rate for SMEs:** Belgium provides three different tax brackets for companies with taxable income below €323,750. The lowest tax rate is 28.84% for taxable income of less than €25,000.
3. **Capital gains tax rate for individuals:** The capital gains tax in Belgium of 16.50% is lower than the EU average (18.6%).

Belgium has an *unfavourable* environment in terms of:

1. **Fund structures:**
   - Belgian fund structures are not tax transparent for domestic investors' income tax purposes.
   - Management charges are liable to VAT.
2. **Merger Regulation:** The notification of a merger is mandatory and the parties are not permitted to take irreversible measures before a decision is taken.
3. **Pension funds:** Pension funds can invest in private equity, but only under certain quantitative restrictions.
4. **Company tax rate:** The company tax rate in Belgium is 40.17%, which is the second highest among the EU member countries.
5. **Tax incentives for private individuals:** There is no tax incentive for private individuals investing in private equity.
6. **Stock options taxation:** Stock options are taxed on grant. The specific situation in Belgium can lead however to a more attractive taxation as for unquoted shares, the taxable amount is limited to 7.5% of the market value of the shares (if exercisable within 5 years of grant). This initially leads to a low taxation charge, while the future value growth is subject to capital gains tax.
7. **Entrepreneurial environment:** Belgium, together with Greece, has the least entrepreneur-friendly environment. In Belgium, only paid-up capital requirements for a private limited company are lower relative to other countries, while all other variables measuring the administrative effort necessary to start a business are higher.
8. **Fiscal R&D incentives:** Belgium offers several fiscal R&D incentives, namely on business R&D expenditures, R&D capital expenditures and for the co-operation between firms and research institutes or universities. None of them however, can be considered as good examples according to the survey 'Corporation Tax and Innovation', European Commission, 2002. The criteria for evaluation is based on the incentives' clarity, simplicity, certainty, legal compliance, equality among firms and effectiveness in obtaining the incentive.

Denmark

Denmark (2.48):

It should be noted that Denmark is not included in the Fund structure comparison, because most investment activities are structured in a private limited company, investing its own equity capital.

Denmark is characterised by a *favourable* environment in terms of:

1. **Pension funds:** Pension funds can invest in private equity with no quantitative restriction.
2. **Company tax rate:** The company tax rate in Denmark is 30%, which is slightly below the EU average (32.6%).
3. **Entrepreneurial environment:** The entrepreneurial environment in Denmark is generally favourable in terms of the time and cost involved in setting up a business. A notable deficiency however, is the extensive capital required to start a company.

Denmark has an *unfavourable* environment in terms of:

1. **Merger Regulation:** The notification of a merger is mandatory and there is an obligation to suspend a deal until the responsible authority (ies) takes a decision.
2. **Company tax rate for SMEs:** There is no specific company tax rate applicable to SMEs.
3. **Capital gains tax rate for individuals:** The Danish capital gains tax rate for unquoted shares is 43%, which is the highest among EU member states.
4. **Tax incentives for private individuals:** There are no tax incentives for individual investors investing in private equity funds.
5. **Stock options taxation:** Stock options are taxed on exercise.
6. **Fiscal R&D incentives:** Of the six fiscal R&D incentives investigated, only one incentive (for R&D capital expenditure) is provided by Denmark.

Finland

Finland (2.25):

Finland is characterised by a *favourable* environment in terms of:

1. **Fund structures (Limited Partnership):**
   - They are tax transparent for domestic investors' income tax purposes.
   - Neither management charges nor carried interest are liable to VAT.
   - There are no restrictions on the types of investments undertaken.
2. **Company tax rate:** The Finnish company tax rate of 29% is lower than the EU average (32.6%).

Finland has an *unfavourable* environment in terms of:

1. **Fund structures:**
   - Most importantly, Finland is one of the countries where the participation of international investors in Finnish funds creates a permanent establishment.
   - A tax efficient capital investment/incentive for fund managers cannot be incorporated.
2. **Merger Regulation:** The notification of a merger is mandatory and there is an obligation to suspend a deal until the responsible authority (ies) takes a decision.
3. **Pension funds:** Pension funds can invest in private equity, but only under certain quantitative restrictions.
4. **Company tax rate for SMEs:** There is no specific company tax rate applicable to SMEs.
5. **Capital gains tax rate for individuals:** Finnish capital gains are taxed at 29%, which is higher than the EU average (18.6%).
6. **Tax incentives for private individuals:** There are no tax incentives for private individuals investing in private equity.
7. **Stock options taxation:** Stock options are taxed on exercise.
8. **Entrepreneurial environment:** Finnish entrepreneurs need more time to launch their businesses and the capital requirements for a public limited company are higher than in other member countries.
9. **Fiscal R&D incentives:** Although Finland provides a tax incentive for R&D capital expenditure, it provides none of the other five incentives investigated in 'Corporation Tax and Innovation', European Commission, 2002.

France

France (2.09):

France is characterised by a *favourable* environment in terms of:

1. **Fund structures (Fonds Commun de Placement à Risques - FCPR):**
   - FCPRs are tax transparent for domestic investors' income tax purposes.
   - A permanent establishment for international investors can be avoided.
   - A tax efficient capital investment/incentive for fund managers can be incorporated.
   - Carried interest is not liable to VAT.

2. **Company tax rate for SMEs:** A specific company tax rate of 15.45% applies for SMEs, on their income up to €38,120 per annum.

3. **Tax incentives for private individuals:** France provides tax relief (income tax exemption or capital gains tax deferral) for investment in private equity.

4. **Entrepreneurial environment:** In terms of the administrative burden in establishing a company, France has the third best environment for entrepreneurship within the EU. However improvements could be made to the length of time required to set up a public/private limited company.

5. **Fiscal R&D incentives:** France provides tax incentives for the creation of innovative firms and is the only EU country carrying out such an incentive. In addition, tax incentive schemes for business R&D expenditure, R&D capital expenditure, the contracting of researchers and the co-operation between firms and research institutes/universities are provided.

France has an *unfavourable* environment in terms of:

1. **Fund structures:**
   - FCPRs are liable to VAT on management charges. This means that if the management company decides not to charge VAT, it cannot itself deduct it, and is subject to an additional tax charge on the salaries paid out.
   - There are undue restrictions imposed on the types of investments undertaken.

2. **Merger Regulation:** The notification of a merger is mandatory and there is an obligation to suspend a deal until the responsible authority (ies) takes a decision.

3. **Pension funds:** France has (until November 2002) no funded pension fund system.

4. **Company tax rate:** The company tax rate of 34.33% is higher than the EU average (32.6%).

5. **Capital gains tax rate for individuals:** The tax rate for capital gains is 26% (16% income tax plus 10% surtax for social contributions), which is higher than the EU average (18.6%).

6. **Stock options taxation:** Stock options are taxed on exercise.

Germany (2.41):

Germany is characterised by a *favourable* environment in terms of:

1. **Fund structures (Limited Partnership):**
    - German fund structures are tax transparent for domestic investors' income tax purposes.
    - A permanent establishment for international investors can be avoided.
    - A tax efficient capital investment/incentive for fund managers can be incorporated.
    - There are no restrictions on the type of investments undertaken.

    It should be noted that the fund structure regulation in Germany is currently under review and could result in a less favourable situation in the future. In particular, the criteria for treating funds as either an asset manager, or a business partnership, are currently under review.

Germany has an *unfavourable* environment in terms of:

1. **Fund structures:**
    - Management charges are liable to VAT.
    - Carried interest is liable to VAT.
2. **Merger Regulation:** The notification of a merger is mandatory and there is an obligation to suspend a deal until the responsible authority (ies) takes a decision.
3. **Pension funds:** German pension funds can invest in private equity, but only under certain quantitative restrictions.
4. **Company tax rate:** The company tax rate in Germany is approx. 38-40% (depending on the municipality of the company), which is above the EU average (32.6%).
5. **Company tax rate for SMEs:** There is no specific company tax rate applicable to SMEs.
6. **Capital gains tax rate for individuals:** The capital gains tax rate for individuals is up to 25.58%, which is above the EU average (18.6%).
7. **Tax incentives for private individuals:** There are no tax incentives for individual investors to invest in private equity.
8. **Stock options taxation:** Stock options are taxed on exercise.
9. **Entrepreneurial environment:** Opening a private limited company in Germany requires more time, cost and capital than is the case in other EU member countries. Likewise for a public limited company, more time and costs are involved.
10. **Fiscal R&D incentives:** Germany obtains the lowest score for this criteria, due to a lack of fiscal R&D incentives. However, it should be noted, that Germany does provide R&D incentives in the form of financial incentives. But this is not included in 'Corporation Tax and Innovation', European Commission, 2002.

Greece

Greece (1.96):

Greece is characterised by a *favourable* environment in terms of:

1. **Fund structure (Closed-end Venture Capital Mutual Fund - AKES):**
   - AKES are tax transparent for domestic investors' income tax purposes.
   - A permanent establishment for international investors can be avoided.
   - A tax efficient capital investment/incentive for fund managers can be incorporated.
   - Management charges and carried interest are VAT exempt.

2. **Capital gains tax rate for individuals:** Greece taxes capital gains at 5% only.

3. **Tax incentives for private individuals:** Greece provides tax incentives for private individuals if they invest through the special purpose vehicle AKES.

Greece has an *unfavourable* environment in terms of:

1. **Fund structure:** There are undue restrictions on investments undertaken by the fund.

2. **Merger Regulation:** The notification of a merger is mandatory and there is an obligation to suspend a deal until the responsible authority (ies) takes a decision.

3. **Pension funds:** Greek pension funds can invest in private equity (155492/B. 638 Joint Decision), with a quantitative restriction.

4. **Company tax rate:** The Greek company tax rate is 35%, higher than the EU average (32.6%).

5. **Company tax rate for SMEs**: There is no specific company tax rate applicable to SMEs.

6. **Entrepreneurial environment:** In terms of administrative burden involved in the establishment of a company, involved in the establishment of a company, Greece has (together with Belgium), the least entrepreneurial environment within the EU. Only the time to set up a private limited company is lower than in the other European countries. All other variables are higher.

7. **Fiscal R&D incentives:** Greece provides only one fiscal incentive for R&D, namely for R&D capital expenditure. According to clarity, simplicity, certainty, legal compliance, non-discrimination and effectiveness of the incentive, this incentive can be seen as a good example for other countries. 'Corporation Tax and Innovation' European Commission, 2002.

Ireland

Ireland (1.58):

Ireland is characterised by a *favourable* environment in terms of:

1. **Fund structures (Limited Partnership):**

   Irish fund structures are optimal as they fulfil all of the following conditions:
   - Tax transparency for domestic investors' income tax purposes.
   - Ability to avoid a permanent establishment for international investors.
   - Ability to incorporate a tax efficient capital investment/incentive for fund managers.
   - Ability to avoid paying VAT on management charges and on carried interest and,
   - Freedom from excessive restrictions on investments.

   While Irish fund structures are favourable according to the above criteria, limited partnerships are restricted to 20 limited partners. This hinders the number of investors and can oblige the structuring of several parallel funds, raising additional costs.

2. **Pension funds:** There are no legal restrictions on investment in private equity by pension funds (prudent man rule).

3. **Company tax rate:** The Irish company tax rate is the lowest in the EU (16%) and as of 1 January 2003, even lower at 12.5% (for trading profits).

4. **Company tax rate for SMEs:** Ireland has a special company tax rate of 12.5% for SMEs.

5. **Tax incentives for private individuals:** In Ireland special private equity-related tax schemes allow for the cost of shares to be written off against income.

6. **Entrepreneurial environment:** Ireland has the EU's most favourable environment for entrepreneurship, with the lowest time, cost and capital requirements for setting up private or public limited companies.

7. **Fiscal R&D incentives:** In Ireland, the fiscal incentives for R&D capital expenditure and the transfer of technologies are considered good examples of fiscal R&D incentives. 'Corporation Tax and Innovation', European Commission, 2002.

Ireland has an *unfavourable* environment in terms of:

1. **Merger Regulation:** The notification is mandatory and there is an obligation to suspend the deal until a decision is taken by the relevant authorities.

2. **Capital gains tax rate for individuals:** The capital gains tax rate in Ireland is 20% and slightly above the EU average (18.6%).

3. **Stock options taxation:** Stock options are taxed on exercise.

Italy

Italy (1.96):

Italy is characterised by a *favourable* environment in terms of:

1. **Fund structures (Fondo Chiuso):**
   - A permanent establishment can be avoided by international investors.
   - No VAT is charged on management charges and on carried interest.
   - There are no undue restrictions imposed on the investments undertaken.

2. **Capital gains tax rate for individuals:** The Italian capital gains tax rate is 12.5% and lower than the EU average (18.6%).

3. **Stock options taxation:** Italy has favourable taxation of stock options, namely when the shares are sold and the profits are realised.

4. **Fiscal R&D incentives:** Italy offers R&D incentives for the contracting of researchers and co-operation initiatives between firms and research institutes or universities. These are considered to be good examples by ‘Corporation Tax and Innovation’, European Commission, 2002. While not optimal, Italy also provides fiscal incentives for business R&D expenditure and R&D capital expenditure.

Italy has an *unfavourable* environment in terms of:

1. **Fund structures:**
   - No tax transparency is provided for domestic investors.
   - A tax efficient capital investment/incentive for fund managers cannot be incorporated.

2. **Merger Regulation:** The notification is mandatory but it should be noted that the suspension of a deal is optional during the investigation stage.

3. **Pension funds:** Italian pension funds can invest in private equity, but are obliged to conform to a quantitative restriction, whereby allocation is restricted to a maximum of 20% of their total assets in shares of closed end funds.

4. **Company tax rate:** The Italian company tax rate is 40.25% and the highest of the 15 member states. It should be noted, that there are plans to lower the company tax rate from January 2003 onwards.

5. **Company tax rate for SMEs:** There is no specific company tax rate applicable to SMEs.

6. **Tax incentives for private individuals:** There are no tax incentives for individual investors to invest in private equity.

7. **Entrepreneurial environment:** According to ‘Corporation Tax and Innovation, European Commission, 2002, the opening of a company in Italy involves more time and cost than in other EU member states. Furthermore the issued capital requirements for a public limited company are high compared to other countries.

Luxembourg

Luxembourg (1.67):

It should be noted that information on carried interest taxation is not included for Luxembourg, except for VAT.

Luxembourg is characterised by a *favourable* environment in terms of:

1. **Fund structures (Fonds Commun de Placement - FCP):**
   - The FCP in Luxembourg is tax transparent for domestic investors' income tax purposes.
   - A permanent establishment can be avoided by international investors.
   - Management charges are not liable to VAT.
2. **Merger Regulation:** Luxembourg is one of the few countries with neither a mandatory notification nor an obligation to suspend the deal until a decision is taken by the relevant authority (ies).
3. **Company tax rate:** The Luxembourg company tax rate is 30.38% and lower than the EU average of (32.6%).
4. **Company tax rate for SMEs:** Luxembourg offers a special company tax rate of 28.3% for a taxable base up to €10,000 per annum.
5. **Capital gains tax rate for individuals:** Capital gains in Luxembourg are tax-free.
6. **Tax incentives for private individuals:** Luxembourg provides tax credits for investments in venture capital certificates and tax allowances for cash contributions to companies.

Luxembourg has an *unfavourable* environment in terms of:

1. **Fund structures:**
   - Carried interest could be liable to VAT.
   - There are undue restrictions imposed on the types of investment undertaken.
2. **Pension funds:** Pension funds can invest in private equity, but only under certain quantitative restrictions.
3. **Stock options taxation:** In the case of listed or tradable stock options, taxation is charged when the option is granted. In all other cases, it is charged when the option is exercised.
4. **Entrepreneurial environment:** Luxembourg shows shortcomings in setting up a private limited company, as entrepreneurs require more time, capital and pay higher administration costs than in other EU countries.
5. **Fiscal R&D incentives:** Only a fiscal incentive for R&D capital expenditure is provided in Luxembourg.

The Netherlands (1.79):

The Netherlands is characterised by a *favourable* environment in terms of:

1. **Fund structures (Limited Partnership):**
   - They are tax transparent for domestic investors' income tax purposes.
   - A tax efficient capital investment/incentive for fund managers can be incorporated.
   - Management charges and carried interest are not necessarily liable to VAT.
   - There are no restrictions on the types of investments undertaken.
2. **Pension funds:** There are no legal restrictions on investment in private equity by pension funds, hence the prudent man rule is applied.
3. **Company tax rate for SMEs:** The Netherlands has a lower company tax rate (29%) on the first €22,689 of profits per annum, which is considered to be an incentive for SMEs, in line with the OECD approach. 'Industry Issues-Taxation, SMEs and Entrepreneurship', 2002.
4. **Capital gains tax rate for individuals:** In the Netherlands, 4% of the fair market value of shares is taxed annually at a rate of 30%, regardless of the actual amount of capital gains realised. For capital gains above a certain level, this is favourable compared to the EU average (18.6%).
5. **Tax incentives for private individuals:** The Netherlands provides a tax incentive for investments in designated venture capital enterprises.
6. **Fiscal R&D incentives:** In the Netherlands the European Commission report 'Corporation Tax and Innovation' 2002 has identified good practices for fiscal R&D incentives, for R&D capital expenditure and the contracting of researchers. Additionally, the Netherlands offers a tax incentive for business R&D expenditure.

The Netherlands has an *unfavourable* environment in terms of:

1. **Fund structures:** As with Finland, the Netherlands is one of the few countries where the participation of international investors creates a permanent establishment. It is possible however, to achieve tax exemption with participation exemption.
2. **Merger Regulation:** The notification is mandatory and there is an obligation to suspend the deal until a decision is taken by the relevant authorities.
3. **Company tax rate:** The company tax rate is 34.5% and higher than the EU average (32.6 %).
4. **Stock options taxation:** Stock options are taxed when granted, unless one elects to be taxed upon exercise. In this case the gain will be treated and taxed as employment income, subject to progressive income tax rates of up to 52%.
5. **Entrepreneurial environment:** As with Germany, the Netherlands performs poorly as regards the creation of a private limited company. In addition, time and paid-up capital requirements for a public limited company are higher than in other member states.

Portugal

Portugal (2.32):

Portugal is characterised by a *favourable* environment in terms of:

1. **Fund structures (Venture Capital Company –VCC/ Fundo de Capital de Risco-FCR):**
   - A permanent establishment can be avoided by international investors.
   - A tax efficient capital investment/incentive for fund managers can be incorporated.
   - Management charges are not liable to VAT.
2. **Capital gains tax rate for individuals:** Capital gains are tax free in Portugal.
3. **Entrepreneurial environment:** Portugal has a favourable entrepreneurial environment according to 'Benchmarking the Administration of Business Start-Ups', European Commission, 2002. Improvements can however be achieved with the time required to set up a private limited company and the costs and paid-up capital required to found a public limited company.
4. **R&D incentives:** In Portugal there are fiscal incentives for business R&D expenditure, R&D capital expenditure, the contracting of researchers and the co-operation between firms and research institutes or universities.

Portugal has an *unfavourable* environment in terms of:

1. **Fund structures:**
   - They are not tax transparent for domestic investors' income tax purposes.
   - Carried interest is liable to VAT.
   - There are undue restrictions imposed on the types of investment undertaken.
2. **Merger Regulation:** The notification is mandatory and there is an obligation to suspend the deal until a decision is taken by the relevant authorities.
3. **Pension funds:** Pension funds can invest in private equity, but only under certain quantitative restrictions.
4. **Company tax rate:** The Portuguese company tax rate is 33% and slightly higher than the EU average (32.6%).
5. **Company tax rate for SMEs:** There is no specific company tax rate applicable to SMEs.
6. **Tax incentives for private individuals:** There are no tax incentives for individual investors investing in private equity funds.
7. **Stock options taxation:** Stock options are taxed on exercise.

Spain

Spain (2.17):

Spain is characterised by a *favourable* environment in terms of:

1. **Fund structures (Sociedad de Capital Riesgo – SCR/ Fondo de Capital Riesgo- FCR):**
   - As with Portugal, a permanent establishment can be avoided by international investors.
   - A tax efficient capital investment/incentive for fund managers can be incorporated, but is complicated.
   - Management charges are not liable to VAT.
2. **Company tax rates for SMEs:** Spain offers a special company tax rate of 30% for companies with a taxable base of up to €90,151.
3. **Capital gains tax rate for individuals:** The capital gains tax rate is 18% and slightly lower than the EU average (18.6%).
4. **Entrepreneurial environment:** Spain has a favourable entrepreneurial environment, although the cost of setting up a business and the issued capital requirements for a public limited company are higher than in other EU countries.
5. **Fiscal R&D incentives:** Spain has the most favourable environment towards R&D. Incentives are in place for business R&D expenditure and R&D capital expenditure, which rate as recommendable examples for other countries according to ‘Corporation Tax and Innovation’, European Commission, 2002. Moreover, Spain provides fiscal incentives for the transfer of technologies, the contracting of researchers and the co-operation between firms and research institutes, which can however, be improved when evaluated against the incentives clarity, simplicity, certainty, legal compliance, equality among firms and effectiveness in obtaining the incentive.

Spain has an *unfavourable* environment in terms of:

1. **Fund structures:**
   - No tax transparency for domestic investors is provided under the Spanish legislation although it should be mentioned that in certain cases the Spanish authorities have recognised such transparency.
   - Carried interest is normally liable to VAT.
   - There are undue restrictions imposed on the types of investments undertaken.

3. **Merger Regulation:** The notification is mandatory and there is an obligation to suspend the deal until a decision is taken by the relevant authorities.

4. **Pension funds:** Pension funds can invest up to a maximum of 10% of their total fund assets in private equity (quantitative restriction).

5. **Company tax rate:** The Spanish company tax rate is 35% and higher than the EU average (32.6%).

6. **Tax incentives for private individuals:** There are no tax incentives for individual investors investing in private equity funds.

7. **Stock options taxation:** Stock options are taxed on exercise or on granting.

Sweden

Sweden (2.09):

Sweden is characterised by a *favourable* environment in terms of:

1. **Fund structures (Limited Partnership):**
   - Swedish fund structures are tax transparent for domestic investors' income tax purposes.
   - A tax efficient capital investment/incentive for fund managers can be incorporated.
   - Management charges and carried interest are not necessarily liable to VAT.
   - There are no restrictions imposed on the types of investments undertaken.
2. **Company tax rate:** The company tax rate is 28% and below the EU average (32.6%).
3. **Entrepreneurial environment:** Sweden has a favourable entrepreneurial environment, even though the paid-up capital required is higher, compared to other European countries, for both legal forms (private and public limited companies). More days are required in Sweden than in any other member state to set up a private limited company.

Sweden has an *unfavourable* environment in terms of:

1. **Fund structures:** Sweden joins Finland and the Netherlands as one of the few countries, where the participation of international investors in a fund creates a permanent establishment.
2. **Merger Regulation:** Notification is mandatory and there is an obligation to suspend the deal for 25 business days following the notification.
3. **Pension funds:** Pension funds can invest in private equity, but are subject to a quantitative restriction.
4. **Company tax rates for SMEs:** There is no specific company tax rate applicable to SMEs.
5. **Capital gains tax rate for individuals:** The capital gains tax rate for individuals is 30% and higher than the EU average (18.6%).
6. **Tax incentives for private individuals:** There are no tax incentives for individual investors investing in private equity funds.
7. **Stock options taxation:** Stock options are taxed on exercise.
8. **Fiscal R&D incentives:** Sweden only provides fiscal incentives for R&D capital expenditures and the contracting of researchers.

The UK (1.20):

The UK is characterised by a *favourable* environment in terms of:

1. **Fund structures (Limited Partnership):** UK fund structures are optimal for all six variables.
   - They provide tax transparency for domestic investors' income tax purposes.
   - A permanent establishment can be avoided by international investors.
   - A tax efficient capital investment/incentive for fund managers can be incorporated.
   - Management charges and carried interest are not necessarily liable to VAT.
   - There are no restrictions imposed on the types of investments undertaken.
2. **Merger Regulation:** The UK joins Luxembourg as one of the few countries with neither mandatory notification nor an obligation to suspend a deal until a decision is taken.
3. **Pension funds:** Pension funds can invest in private equity and venture capital according to the prudent man rule. Nevertheless, the 'Minimum Funding Requirement' imposed on UK pension funds distort their investment decision-making and impedes them from increasing their allocation to the asset class.
4. **Company tax rate:** The company tax rate in the UK is 30% and below the EU average (32.6%).
5. **Company tax rates for SMEs:** There is a special company tax rate for SMEs of 19%.
6. **Capital gains tax rate for individuals:** The capital gains tax rate of 10% (for business assets) is lower than the EU average (18.6%).
7. **Tax incentives for private individuals:** Private investors in the UK receive income tax relief from their investments in venture capital.
8. **Entrepreneurial environment:** In terms of the administrative burden involved in the establishment of a company, the UK has the second-best entrepreneurial environment in the EU. Unlike Ireland (the best performer), the minimum issued capital requirements for a public limited company in the UK are higher than in other EU countries.
9. **Fiscal R&D incentives:** An example of a fiscal R&D incentive in the UK, deemed by 'Corporation Tax and Innovation', European Commission, 2002 as recommendable, is the tax treatment of business and R&D capital expenditure. Furthermore, the UK has tax incentives for the contracting of researchers and for co-operation between firms and research institutes or universities. The latter two incentives do however show deficiencies in their clarity, simplicity, certainty, legal compliance, equality among firms and effectiveness, which form the basis for the Commission's evaluation.

The UK has an *unfavourable* environment in terms of:

1. **Stock options taxation:** Unapproved stock options are taxed on exercise. It should be noted that taxation on sale is possible for stock options from approved schemes and 'Enterprise Management Incentive' schemes. This more favourable tax treatment does however impose restrictions on the option scheme.

5 Methodology

A standardised procedure was followed in researching this report, based on detailed definitions of individual variables. These are outlined in more detail below.

The objective has been to form the basis for discussion about the current fragmented policy environments of European Union member states, as well as to highlight those areas where improvements to the tax and legal environment could positively impact the development of private equity and venture capital.

But, while the results do provide a strong and useful tool, supporting the analysis of the legal and tax environments in EU member states, it is important that they should be interpreted with care.

To allow for a comparison to be made between different national environments, information on the 10 core criteria was collected for each member state during the period February to November 2002. A score was calculated - per issue, and then per country. ‘1’ was the best score, accorded to a favourable environment, with ‘2’ and ‘3’ indicating less favourable conditions, where there is room for improvement. Finally, a composite score was calculated by taking an average of all scores per country. The composite score enabled the assessment of current conditions in all member states to be made. It is important to emphasise that equal weight was accorded to all of the 10 criteria when calculating the composite score. This means that no distinction was made regarding the relative impact of the individual issues studied.

This document does not claim to be an exhaustive comparison. A possible extension of the study would include a weighting scheme to distinguish between the relative importance of the variables. Further research should also be undertaken concerning the taxation of institutional investors. Another improvement would be to include additional factors contributing to an entrepreneurial environment, such as training for entrepreneurs, cultural differences in the perception of entrepreneurship and bankruptcy rules. Finally, an analysis of the financial incentives provided by EU member state governments for R&D investments could also enhance this report.

EVCA would like to thank all the contributors who have been involved in the data collection process and, in particular, the members of the EVCA Tax and Legal committee.

1. Fund structures:

The evaluation of fund structures across Europe was based on six different variables.

1. Tax transparency for domestic investors.
2. Ability to avoid a permanent establishment for international investors.
3. Ability to incorporate a tax-efficient, performance-related incentive or investment in the form of capital for fund managers of private equity and venture capital funds.
4. Ability to avoid paying VAT (Valued Added Tax) on management charges.
5. Ability to avoid paying VAT on carried interest.
6. Freedom from undue restrictions on investments.

The study reviewed the situation in 14 EU member states.[1]

- A positive score of ‘1’ was accorded to those countries, which fulfilled all 6 variables.
- A negative score of ‘3’ was accorded to those countries without tax transparency for domestic investors, without the ability to avoid a permanent establishment, without the ability to incorporate a tax efficient capital investment/incentive for fund managers, without the ability to avoid paying VAT on management charges and carried interest and with undue restrictions on the types of investments undertaken.

It should be noted that the fund structure analysis refers to a domestic fund and does not cover the possibility of using foreign fund structures. It could be argued that these foreign structures are sub-optimal solutions, due to the transaction costs, which they imply.

[1] Most Danish private equity companies invest their own share capital in portfolio businesses. The traditional structure with private equity and venture capital funds managed by a management company is not yet common in Denmark. Any information related to fund structures in Denmark would be highly theoretical, hence, Denmark is excluded from the fund structures evaluation.

2. Merger regulation:

- A positive score of ‘1’ was accorded to those countries in which notification is not mandatory and where there is no obligation to suspend a deal during the investigation process.
- A negative score of ‘3’ was accorded to those countries in which notification is mandatory and where there is an obligation to suspend the deal during the investigation process.

3. Regulation on pension funds:

- A positive score of ‘1’ was accorded to those countries in which pension funds can invest in private equity, with no quantitative restrictions (prudent man rule).
- A score of ‘2’ was accorded to those countries in which pension funds are free to invest in private equity, but where there is a quantitative limitation (percentage of the total assets determined by a specific regulation). This is also referred to as the ‘Prudent Man Rule plus’.
- A score of ‘3’ is assigned to those countries where pension funds are prohibited from investing in private equity.

4. Company tax rate (on profits and dividends)

The company tax rates given refer to the nominal tax rate for each country. Although effective tax rates better reflect the real tax burden of a company, they require extensive amounts of data. Moreover, it should be kept in mind that according to the European Commission's report ‘Company Taxation in the Internal Market’, 2001, p.5, "the different national nominal tax rates on profits (statutory tax rates, surcharges and local taxes) can explain many of the differences in effective corporate tax rates between countries".

For our comparison, the highest tax rate in a specific country was selected as the benchmark and the average tax rate for the 15 member countries was calculated. The individual countries were than evaluated against this average, which is 32.6%.

- A positive score of ‘1’ was accorded to those countries with a rate below the nominal EU average.
- A score of ‘2’ was accorded to those countries with a nominal average rate equal to the EU average.
- A negative score of ‘3’ score was accorded to those countries with a rate above the EU average.

The above rates include local and municipal taxes on income in the countries in which they exist.

5. Company Tax rate for SMEs (Small and Medium sized Enterprises)

- A positive score of ‘1’ was accorded to those countries with a specific tax rate for SMEs, different to that which is domestically implemented for other companies.
- A negative score of ‘3’ was accorded to those countries without a specific tax rate applicable to SMEs.

Where there exist several tax rates for SMEs, the lowest tax rate was chosen as a benchmark.

6. Capital gains tax rate for individuals:

To evaluate the variable of capital gains taxation for individuals, an EU average tax rate was calculated and compared to the different national tax rates. The EU average capital gains tax rate was 18.6%.

- A positive score of '1' was accorded to those countries with a capital gains tax rate below EU average.
- A score of '2' was accorded to those countries where the tax rate equals the EU average.
- A negative score of '3' was accorded to those countries with a capital gains tax rate above EU average.

The capital gains tax rates presented are based on the following assumptions:

- The holding period of the shares is sufficiently long and the investment is not of a speculative nature (short term investment).
- The shares held represent less than a 'substantial interest' in the respective country.
- The private individual is a professional investor in the case of Belgium.
- In case of a tax range, the higher tax rate is chosen for comparison.

The assessment disregards tax allowances/credits, which might additionally favour the acquisition of shares.

7. Tax incentives for private individuals investing in private equity:

- A positive score of '1' was assigned to those countries with a specific private equity-focused tax incentive for private individuals.
- A negative score of '3' was accorded to those countries without a specific tax incentive for private individuals.

8. Taxation on stock options:

The analysis refers to the point in time at which stock options are taxed. It can be undertaken either 'at grant', 'at vesting' or 'at exercise'. These three solutions lead to a situation where stock options are generally taxed at the time when the money from a possible gain is not yet received. Ideally, if any taxation is adopted, there should be no taxation of unrealised gains. Thus, the fourth and most recommendable situation is the taxation 'at exit' or 'at sale'. Accordingly:

- A positive score of '1' was accorded to those countries in which stock options are taxed on sale.
- A negative score of '3' was accorded to those countries in which stock options are taxed when exercised, granted or vested

9. Entrepreneurial environment:

Although various general obstacles to entrepreneurship prevail (an unfavourable economic climate, insufficient information and a fear of failure), this study focuses only on the complex and costly administrative procedures involved in setting up a business. The basis for this evaluation is a paper published by the European Commission on the administration of business start-ups 'Benchmarking the Administration of Business Start-ups' 2002.

Attention is drawn to two legal structures: the private and the public limited company. The variables analysed cover the typical time necessary to set up a business (average total elapsed business days), the typical administration costs involved and the minimum capital required, both issued capital and paid-up capital[1]. This provides four variables: time, costs and two capital requirement variables for each legal structure and eight entrepreneurship variables in total.

[1] Issued capital refers to the amount of capital, which is issued to shareholders in the form of shares. Paid-up capital is the proportion of issued capital that has been paid for by its shareholders. The difference between the two is uncalled capital which the shareholders are still liable to pay.

An average of each of these variables was calculated, according to which all countries were ranked.

- A positive score of ‘1’ was accorded to those countries with time, costs and capital requirements below the average.
- A score of ‘2’ was accorded to those countries, with time, costs and capital requirements equal to the average.
- A negative score of ‘3’ was accorded to those countries with time, costs and capital requirements above the average.

Based on these assessments, a composite score was calculated for each legal form, as well as a combined score. The latter was then used as a benchmark to classify a country’s environment as favourable (below the average of 2.1) or unfavourable (above the average of 2.1).

10. Fiscal R&D incentives:

The evaluation of fiscal R&D incentives in all EU member states is based on the study ‘Corporation Tax and Innovation’ published by the European Commission Directorate General for Enterprise in 2002. For the purpose of this paper, fiscal R&D incentives were evaluated according to six of 13 original R&D-related variables. These variables are:

1. Tax incentives for business R&D expenditure (e.g. tax credits[2] or allowances).
2. Fiscal incentives for R&D capital expenditure (e.g. free or accelerated depreciation).
3. Technology transfer (e.g. either a tax incentive to support the purchase of a technology or a tax incentive for the developer of a new technology to transfer his know-how)[3].
4. Contracting of researchers (tax incentives that encourage the hiring of specialist personnel e.g. support via personnel income tax or corporation taxes).
5. Co-operation between firms and research institutes/universities (tax incentives for collaborative projects).
6. Tax incentives for the creation of innovative firms (e.g. tax incentives for company spin-outs).

Our study distinguishes between a normal incentive and a good and recommendable incentive, when evaluated according to the EC report’s criteria:

a. **Clarity:** The incentive clearly defines what it seeks to achieve and the activities that it is able to support.
b. **Simplicity:** The incentive is easy to understand.
c. **Certainty:** The incentive gives the companies the certainty of qualifying for it once they begin a project.
d. **Legal compliance:** The incentive complies with all relevant national and international legislation.
e. **Non-discriminatory:** The incentive does not discriminate between firms and does not distort existing market conditions.
f. **Effectiveness:** The incentive is effective in benefiting different firms.

In this study,

- A positive score of ‘1’ was accorded to those countries with a fiscal incentive identified by the EC as an example of a good incentive for innovative activity.
- A score of 2 was accorded to those countries which have a fiscal incentive for innovative activity, but one which is not recommended as a good example by the EC.
- A negative score of ‘3’ was accorded to those countries without a fiscal incentive for innovative activity.

Based on the six identified fiscal R&D variables, a composite score was calculated per variable, per country. The composite score was then used as a benchmark and countries were classified as either favourable (scoring better than the average of 2.5) or unfavourable (scoring less than average of 2.5).

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[2] Tax credit refers to fiscal incentives, which allow firms to deduct a percentage of their R&D expenditure from their tax bills/ liabilities. Tax allowances are incentives as they enable firms to deduct more than 100% of their R&D activity expenditure from the tax base.

[3] An example is the tax exemption from royalties obtained from the use of patents.

6. Information

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- NBG Venture Capital, Greece
- New Economy Development Fund, Greece
- Vectis Capital, Greece
- Preslmayr & Partners Attorneys-at-law, Austria

National Authorities:

Federal Ministry of Finances Austria
The Austrian Federal Economic Chamber
Ministry of Finance Belgium
Danish Ministry of Taxation
Ministry of Finance Finland
Ministry of Finance France
Federal Association of German Banks
Federal Finance Office of Germany
Federal Ministry of Economic Affairs Germany
Federal Ministry of Finance Germany
Hellenic Capital Market Commission Greece
Ministry of Economy Spain
Ministry of Industry Sweden
HM Treasury UK

Private Equity and Venture Capital - National Associations

Association Française des Investisseurs en Capital (AFIC)
Associazione Italiana degli Investitori Institutionali nel Capitale de Rischio (AIFI)
Associação Portuguesa de Capital De Risco (APCRI)
Associación Española de Capital de Inversion (ASCRI)
Austrian Venture Capital Association (AVCO)
Belgian Venturing Association (BVA)
British Venture Capital Association (BVCA)
Bundesverband Deutscher KBG’s (BVK)
Danish Venture Capital Association (DVCA)
Finnish Venture Capital Association (FVCA)
Irish Venture Capital Association (IVCA)
Nederlandse Vereniging van Participatiemaatschappijen (NVP)
The Swedish Venture Capital Association (VENCAP)

6.Information

Other Trade Associations

European Federation for Retirement Provisions (EFRP)
Association of Austrian Investment Companies (Austria)
Association of Austrian Pensionskassen
Ondernemingspensioenfondsen (OPF, Netherlands)
Associação das Empresas Gestoras de Fundos de Pensões, (AEGFP, Portugal)
Asociación de Instituciones de Inversión Colectiva (Inverco, Spain)
Arbeitsgemeinschaft für betriebliche Altersversorgung EV, (ABA, Germany)
Forsikring & Pension (Denmark)
Association Française des régimes et Fonds de Pension (AFPEN, France)
Societa per lo sviluppo del mercado dei fondi pensione (MEFOP, Italy)
Banque Générale du Luxembourg S.A (BGL, Luxembourg)
Association Belge de Fonds de Pension, (Belgium)
National Association of Pension Funds (NAPF, UK)
The Irish Association of Pension Funds (IAPF, Ireland)
The Swedish Association of Institutions for Retirement Provisions (SIRP, Sweden)
The Association of Pension Foundation (Finland)

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7 Appendices

Appendices

Table 1: Scores for the individual variables

Country	Total score	Fund Structures						Merger Regulation		Regulation on Pension Funds	Company tax rate (profits and dividends)
		Tax transparency for domestic investors	Ability to avoid permanent establishment for international investors from treaty or non-treaty countries?	Ability to incorporate a tax efficient capital investment/ incentive for fund managers	Ability to avoid paying VAT on management charges	Ability to avoid paying VAT on carried interest?	Freedom from undue restrictions on investments	Is notification mandatory?	Is there an obligation to suspend?		
Austria	2.53	3	1	1	3	3	3	3	3	2	3
Belgium	2.14	3	1	1	3	1	1	3	3	2	3
Denmark	2.48	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	3	3	1	1
Finland	2.25	1	3	3	1	1	1	3	3	2	1
France	2.09	1	1	1	3	1	3	3	3	3	3
Germany	2.41	1	1	1	3	3	1	3	3	2	3
Greece	1.96	1	1	1	1	1	3	3	3	2	3
Ireland	1.58	1	1	1	1	1	1	3	3	1	1
Italy	1.96	3	1	3	1	1	1	3	1	2	3
Luxembourg	1.67	1	1	N.A.	1	3	3	1	1	2	1
Netherlands	1.79	1	3	1	1	1	1	3	3	1	3
Portugal	2.32	3	1	1	1	3	3	3	3	2	3
Spain	2.17	3	1	1	1	3	3	3	3	2	3
Sweden	2.09	1	3	1	1	1	1	3	3	2	1
UK	1.20	1	1	1	1	1	1	1	1	1	1

Source: EVCA

Table 2: Scores for the individual variables continued...

Country	Company tax rate for SMEs	Capital Gains tax rate for individuals	Tax in-centives for individual investors	Stock options taxation	Fiscal R&D incentives						
					Total score	Tax incentives for business R&D expenditures (e.g. tax credits)	Tax incentives for R&D capital expenditures (e.g. special depreciation rates or write-off possibilities)	Tax incentives to enhance technology transfer	Tax incentives to enhance the contracting of researchers	Tax incentives to enhance the cooperation between firms and research institutes/universities	Tax incentives to promote the creation of innovative firms
Austria	3	3	1	3	2.8	3	2	3	3	3	3
Belgium	1	1	3	3	2.5	2	2	3	3	2	3
Denmark	3	3	3	3	2.8	3	2	3	3	3	3
Finland	3	3	3	3	2.8	3	2	3	3	3	3
France	1	3	1	3	2.0	2	2	3	2	2	1
Germany	3	3	3	3	3.0	3	3	3	3	3	3
Greece	3	1	1	N.A.	2.6	3	1	3	3	3	3
Ireland	1	3	1	3	2.3	3	1	1	3	3	3
Italy	3	1	3	1	2.0	2	2	3	1	1	3
Luxembourg	1	1	1	3	2.8	3	2	3	3	3	3
Netherlands	1	1	1	3	2.1	2	1	3	1	3	3
Portugal	3	1	3	3	2.3	2	2	3	2	2	3
Spain	1	1	3	3	1.8	1	1	2	2	2	3
Sweden	3	3	3	3	2.6	3	2	3	2	3	3
UK	1	1	1	3	2.0	1	1	3	2	2	3

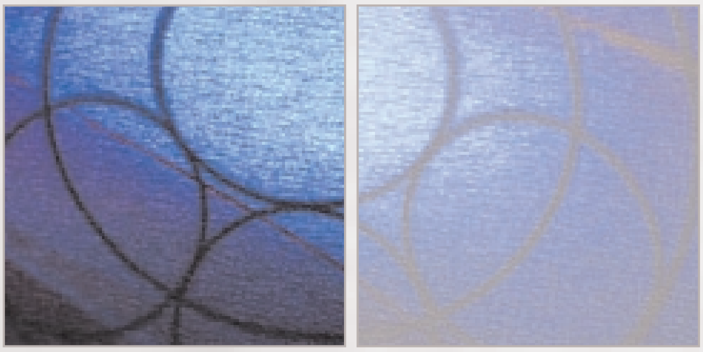
Source: EVCA

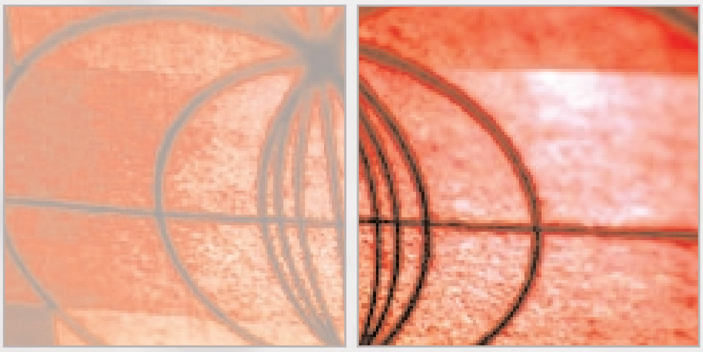
7.Appendices

Table 3: Scores for the individual variables continued...

Country	Entrepreneurial environment	Time and capital involved in setting up a private limited company					Time and capital involved in setting up a public limited company				
	Total score (For both private and public limited company together)	Typical total days	Typical total costs	Minimum issued capital	Minimum paid up capital	Scoring for private limited company	Typical total days	Typical total costs	Minimum issued capital	Minimum paid up capital	Scoring for public limited company
Austria	2.6	2	3	3	3	2.8	1	3	3	3	2.5
Belgium	2.8	3	3	3	1	2.5	3	3	3	3	3.0
Denmark	2.0	1	1	3	3	2.0	1	1	3	3	2.0
Finland	2.1	3	1	1	2	1.8	3	1	3	3	2.5
France	1.4	3	1	1	1	1.5	2	1	1	1	1.3
Germany	2.5	3	3	3	3	3.0	3	3	1	1	2.0
Greece	2.8	1	3	3	3	2.5	3	3	3	3	3.0
Ireland	1.0	1	1	1	1	1.0	1	1	1	1	1.0
Italy	2.3	3	3	1	1	2.0	3	3	3	1	2.5
Luxembourg	2.3	3	3	3	3	3.0	3	1	1	1	1.5
Netherlands	2.5	3	3	3	3	3.0	3	1	1	3	2.0
Portugal	1.8	3	1	1	1	1.5	1	3	1	3	2.0
Spain	1.9	2	3	1	1	1.8	1	3	3	1	2.0
Sweden	1.8	3	1	1	3	2.0	1	1	1	3	1.5
UK	1.3	1	1	1	1	1.0	1	1	3	1	1.5

Source: EVCA





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